

DR. LIPSKY: I would like to thank the Commission for the opportunity to be here.

Mr. Hale may have run a slight time deficit. I will try to keep us on schedule by running a slight surplus. My remarks, therefore, will not repeat the aspects of previous testimony that have been on target, and with which I agree.

The question that you focused on in your charge to us was to address the sustainability of the current deficit. Effectively you're asking us "Has the deficit become so large that it needs to be addressed by policy, or should it be viewed as a natural consequence of acceptable market forces? If the latter is true, should it be anticipated that the deficit will subside without undue disruption to our economy?"

The contrast is striking between the current deficit of today and the experience of the 1980s. The earlier period is the only modern precedent we have of a current deficit of the size relative to GDP that we have today.

In the mid-'80s, we were plagued with the combination of an extremely loose fiscal policy, a large fiscal deficit, and a very tight monetary policy that produced very high real interest rates, a significantly overvalued dollar, and a surge in imports. In essence,

foreign savings was being used to finance our public dissavings

At that time, the United States had a then-record current account deficit. The deficit was associated with competitiveness problems for U.S. manufacturing companies. You will recall that the U.S. manufacturing sector was called the Rust Belt back then.

In contrast the dollar today seems relatively fair-valued, and U.S. manufacturing is globally competitive.

In fact, it's remarkable that effective exchange rate measures indicate that the dollar's value is back to where it was in 1973 when the Breton Woods system first broke apart.

Moreover, real interest rates are lower than they were at that time. The emergence of this large trade deficit, as we've heard earlier, reflects in large part the shortfall of growth or the large amount of excess capacity in the rest of the world that has reflected weakness in our trading partners' economies.

In addition, the perception of investors worldwide of the U.S. economy has improved, along with the performance of the U.S. economy. In essence, the recent data suggests that despite the length of the

U.S. expansion, the latest data look more like those of a so-called tiger economy than they do of a mature industrial economy.

The U.S. economy in the past few years has enjoyed stronger growth than other G.F. countries, together with faster productivity growth than our trading partners, in a context of relatively balanced monetary policy.

As a result, the unprecedented U.S. investment surge shouldn't be viewed as something either surprising or necessarily bad in any sense. Nonetheless, it should be pointed out that there has been concern expressed by some that this record capital inflow has been associated with the rapid rise in U.S. asset values, especially in the stock market.

Therefore, it should be noted that the valuations of high-tech stocks globally has been relatively similar. In other words, the surge in equity values in the high-tech sector in the United States has been mirrored elsewhere in the world. The rise in equity prices has been more notorious here mainly because the U.S. high-tech sector is so much bigger than the same sector elsewhere.

Because there's no evidence that the valuations of high-tech companies in the U.S. are disjoint from the valuations of similar companies

elsewhere in the world, a simple assertion that there's something going wrong here needs to be examined much more carefully.

In fact, one of the factors underlying the ease with which the U.S. deficit has been financed has been the surge in business investment, in productivity growth and in corporate profitability. While many analysts have focused on the strength of consumption spending, the aspect of the U.S. economy that is absolutely unprecedented is the strength of business capital spending. Today, business expenditures on capital goods are higher as a percentage of GDP than ever before in our history. The rate of business capital spending at present is approximately double the average rate of the 1980s and triple the average rate of the 1960s.

In other words, the surge in capital inflows has financed a surge in business investment that has been associated with the surge in U.S. productivity growth. When viewed this way, the current deficit is just the mirror image of the U.S. investment and productivity boom, at least so far.

Moreover, the increasing openness of global capital markets has increased gross flows both into and out of the United States.

The record U.S. current account deficit today represents only about 25 percent of the gross capital inflows into the U.S. economy. The current deficit, therefore, represents a snapshot of these large, two-way flows. To view the deficit as a kind of bill presented to international investors at the end of the year tends to suggest that a problem exists that, in fact, does not.

I'm sure it's hard to conclude that the growth of the U.S. deficit simply reflects some domestic problems.

Of course, it also would be silly to look at a current deficit this large relative to GDP and assume that there are no risks. An obvious risk would be if barriers were erected to impede the relatively free flow of capital, goods and services. Another risk would be if the soundness of the U.S. economy comes into question.

A conventional view of the risk created by the current deficit is that the dollar's value could collapse. But it's not clear to me why that should occur. It doesn't strike me as immediately obvious why a dollar collapse would be likely unless something suddenly reduces the attractiveness of investment in the U.S.

Why do I put it this way? Because oftentimes the discussions of this issue treat the pool of global savings as fixed, and that there is an implicit battle to use those savings. Thus, if the United States doesn't receive these inflows then somebody else will.

Of course, the flow of savings globally is not fixed and will respond to attractiveness of opportunities, here and elsewhere. In other words, successful economic reform abroad should increase the opportunities for investment, but they also would increase savings.

Rather, it strikes me that the most relevant risk to the U.S. economy would be if the good inflation performance is threatened.

Accelerating inflation would make the United States substantially less attractive as a magnet for investment in general and not just for foreign investment.

Thank you.

CHAIRMAN D'AMATO: Thank you for your comments, Dr. Lipsky, and thank all the panelists for their oral and written testimony, which we'll be digesting.

Now we'll open the panel up for questions. Commissioner Papadimitriou.

VICE CHAIRMAN PAPADIMITRIOU: Let me first thank you all for coming and for your participation. I want to echo Mr. D'Amato's sentiments that your testimony will be very important to the deliberations of this Commission.

I have a general question, which I would be interested in the answer from each of you; and that is, if I were to have understood what you have said, the problem with the trade deficit is not the only problem, but rather the most significant problem is actually the savings rate in the U.S., yet Dr. Lipsky indicated that one shouldn't worry about savings because if we take the global picture regarding savings, the trade deficit can actually continue for some time.

My concern is that if one is to take savings and investment, this cannot be taken outside of the context of income. So if we were, for instance, to indicate or propose that there are some policies that will increase savings or decrease consumption, that

might have an effect not only in terms of decreasing the trade deficit, but of course, it might put the economy in a downward spin.

How would we avoid this, certainly monetary policy has a lot to do with it, but how do we reconcile these two?

DR. LIPSKY: Perhaps if I might, I wouldn't want to be misunderstood as suggesting that a cavalier attitude is justified that there's always savings available under any and all circumstances. The implication of your question is whether the low savings rate in the U.S. economy at this time should be viewed as a source of concern.

To address this issue, you have to ask if there is something that is distorting the savings performance of the U.S. economy. In other words, is there something that is artificially lowering savings in a way that would suggest that the current low savings reflects a policy error of some kind.

At present, however, I find it hard to discern a policy change that will have caused an artificial depression in U.S. savings. As a result, I would rather consider that the current low savings rate represents a rather short-term phenomenon in the U.S. economy that will be naturally corrected.

That being said, if the question is whether there is a policy innovation that could be put in place to improve the savings performance of the U.S. economy, I would say yes. I expect that significant domestic tax reform, including a broader base, simpler rules and lower rates would improve the savings performance of the U.S. economy.

MR. HALE: There's no doubt that we could pursue tax changes that would bolster our savings rate over time. There are examples from other countries of compulsory super annuation programs and other similar policies that have been used in a variety of countries, both industrial and developing to raise the savings rate.

I think the problem we've had in recent times is very simple. The American people are saving the tremendous appreciation they've seen in their financial asset prices. The wealth gains from the stock market for the household sector of the United States in recent years has been in the trillions of dollars.

Indeed, if you look at Federal Reserve models of consumption and wealth, they suggest right now that our savings rate is remarkably high. The Federal Reserve models would suggest that the wealth

gains have been so large we should have had even greater growth in consumption.

And if we had had greater growth in consumption, the savings rate wouldn't be two and a half percent. It might be closer to zero. We thought briefly it was zero, but then revised the data.

So I think on a one-year view or an 18-month view, there's probably not very much we can do about this phenomenon. The fact is these wealth gains have been very large. They haven't been fully realized. I think there will be further wealth gains to come, and therefore, the savings rate will stay subdued.

Now at some point the financial buoyancy will calm down. We will not have wealth gains in the same we've had in recent years, and 18 percent compound return equities, for example, and when that happens, we'll see a different kind of equilibrium emerge, and then households will achieve their wealth accumulation targets by deferring consumption, not just by enjoying rising equity of prices, and that will set the stage for the savings rate to gradually improve.

We can reinforce it. We can strengthen it by experimenting with Social Security privatization, by experimenting with new tax allowances for savings, but my sense is those particular agendas will be modest in

their consequence compared to what's actually happening right now in the private sector with the growth in financial asset prices.

DR. DUGGER: Thank you, sir. It's a very excellent question.

The burden of my testimony is that markets are discontinuous. They don't adjust smoothly, and that there is a disconnection between the trade deficit and the capital account, and the capital account is likely to adjust much more aggressively than the trade account can.

As a consequence, from a policy standpoint looking back over this past decade, actually we have to look back two decades. All of you remember a time when you could deduct interest expense from consumer credit borrowings from your taxes. We had in the 1960s and 1970s and 1980s an explicit consumption incentivizing structure in place in the United States. That structure is carried forward into the 1990s, and in conjunction with this very, very strong stock market boom has led to this enormous consumption orientation that we have.

The concern that I'm expressing today in the way that financial markets adjust is that we can get a period of reallocation of savings that contracts U.S. capital market values before the global savings

generally rises from stronger growth abroad and in Asia.

It may be that the decline in value of Internet stocks that were related to consumption, mainly the Internet companies which functionally served as ways of marketing consumer goods and services, those declines began last year. It may be that the narrowness of the strength of the stock market, focused as it solely in stocks which have the potential of earnings outside the United States, simply capital goods B to B (phonetic) technology stocks, the fact that the narrowness of the stock market rise is limited to this very small group of companies suggests that the kind of transition that I'm talking about in which consumer sectors in the United States, representing as they might what is old about the United States, are already in transition or already in adjustment.

In this context, the current account, capital account adjustment is already actively underway in the United States. For most Americans their stock holdings have not gone up very much. If you look at the data from the Federal Reserve consumer finance survey published in January, most of the stock holdings are in a very high-income group of our population. That population can bear the burden of a reduction in value, but the broad middle class of the United States

has benefited somewhat, but it has not benefited significantly in recent years from this stock market run-up.

So the potential we have is that the savings adjustment is going to take place; it may already be taking place, but it's going to take place as a consequence of market processes. It did in the other countries we have talked about during this past decade, and it's most likely going to occur as a result of market forces in the United States also.

DR. DUDLEY: I think the big issue, in terms of our dependence on foreign capital, is whether the terms in which we get that capital change. That is a real vulnerability of the U.S. economy.

Right now we're getting the foreign capital on favorable terms. The dollar has been strong rather than weak over the last few years, and so there's been no conflict between the interest rates that we want to have for domestic reasons and the interest rates that are high enough to attract foreign capital.

There is a potential vulnerability if foreign investors' attitudes towards the U.S. change, and I think one thing that's really helped us and prevented the current account deficit from being even larger is what we've done on the fiscal side.

If we weren't running large fiscal surpluses, national savings would not have risen over the last few years. So our problems would have been even more pronounced.

The best thing we can do in the short run is to maintain that fiscal discipline and not spend the surpluses. So I would agree with Fed Chairman Greenspan on that point.

CHAIRMAN D'AMATO: Thank you.

Commissioner Zoellick.

COMMISSIONER ZOELLICK: I also would like to thank all four of you for very thoughtful statements. I have a few interconnected questions, and I would welcome answers from any of you.

First, is there a level of current account deficit in either absolute or percentage terms that should lead the U.S. government to try to promote adjustment other than through encouraging growth abroad or through increasing savings at home?

And second, I think other than Dr. Dugger most of you expect a gradual adjustment, but you recognize that there could be a sharp shift, and given this possibility of sharp shift, what would you recommend for policy actions, either (a) to make it less likely or (b) to mitigate effects?

And then third, the reverse side of that is would you caution against certain actions that might lower the current account deficit, but at the price of economic harm that would not be worth it?

MR. HALE: On the questions I had said the following. There's no particular number that we can set as a target for the current account deficit. We're on a kind of economic mystery tour.

We were shocked in 1987 when the current account deficit came close to four percent of GDP, then produced some major books in Washington at the time, people like Steven Maris predicting a crisis, a possible global depression.

In the end, we had a soft landing through a mixture of Central Bank intervention and good luck in the markets. Today we're back at four percent of GDP.

This is also provoking a new wave of articles and books on the same topic and the conclusion because the experience of ten years ago is that we can probably sustain it for a while, but the fact is that we can never know for certain because this is a process driven by many events inside and outside our control, and we're always exploring.

Just to put it in perspective, countries like Australia have recently run current accounting deficits at six percent of GDP. Three or four years

ago, Thailand was eight or nine percent of GDP. That ended very unhappily, but the cause of the problem is not the current account deficit. It's that it was funding a massive real estate boom that produced several hundred billion dollars of nonperforming bank loans.

If the investment counterpart to the current deficit is producing high returns, you can finance a large deficit internally. But, if it's producing a speculative bubble, if it's producing bad investments, even a modest deficit can be quite destructive.

On the second question, I would say that the overwhelming thrust here over the next year, especially as we approach a presidential transition, and you're involved with one of the candidates so I make this point doubly for you, is to emphasize continuity.

We do not want to have, in my opinion, on a one-year view, a major change in attitudes on the part of the U.S. Treasury towards the U.S. dollar. We have had several major devaluations of the modern period, often caused by new Treasury Secretaries who felt that the dollar devaluation by itself could be a solution to a problem.

There will be periods from time to time when a dollar devaluation might be appropriate, but if a new Administration goes off on the track of abdicating a weaker dollar immediately, the danger is that the process might get out of control, and then you could have a very volatile market adjustment that would drive up bond yields and depress the stock market and then basically create problems for the U.S. economy.

I think we have to be very, very careful in using the exchange rate as a policy lever. I'm not ruling it out forever. I'm just saying that as we go through a transition, it's very, very important to be sensitive to market confidence because the fact is they're out there, millions of traders, watching the headlines all day looking for a reason to trade, and if you feed them information, feed them rhetoric, feed them headlines that suggest major policy upheavals and major policy changes, the consequences could be quite destabilizing.

CHAIRMAN D'AMATO: Commissioner Wessel.

COMMISSIONER ZOELLICK: Could I just follow up, in particular, with Dr. Dugger? I gather your answer to my first question is that we're already at the level because you believe the adjustment is taking

place, but then I'd like to focus particularly on the policy dimensions.

DR. DUGGER: What policy action should --

COMMISSIONER ZOELLICK: The policy dimensions either that you believe we should take or shouldn't take.

DR. DUGGER: Well, we should take no action which adds to the already very, very strong consumption orientation in our country. Bill Dudley already commented that he favors a continuation of the federal surplus. I completely agree with that. Anything else that can be done to encourage people to reduce consumption moderately in a sensible, constructive way would be useful.

It's going to happen in any case because of the aging of our society. We are to see over the next 24 to 36 months the flowering of a kind of aging crisis in Japan. The aging of the population in Europe is becoming an acute political, as well as policy issue.

It is clearly a very important policy question here, but we have a very, very substantial increase in the number of people who are entering their 50s at the present time. Those of us who have past that important watershed in life know how it can affect your thinking.

The prevalence on the Internet of retirement planning calculators, a large association on retirement benefits has statistics which indicate that people who use these retirement calculators change their behavior. They begin to save more.

So literally just the aging of our population is going to affect the consumption savings balance, and anything we can do to help that process occur in a constructive, sustained, stable way is what we ought to do.

COMMISSIONER ZOELLICK: With the Chair 's indulgence, I'll just note that I don't believe any of you said we should not take protectionist actions, and this may be the difference between Washington and New York, because you may think that's a presumed avoidance, but as Senator Schumer said, I wouldn't bet on it.

So if you think that's an important step not to take, you might want to comment on it at some point.

DR. DUDLEY: I was just going to comment on that point.

(Laughter.)

CHAIRMAN D'AMATO: We knew he was going to comment on it.

DR. DUDLEY: I think it's very important that the U.S. continue to be perceived globally as an advocate of free trade because if we were perceived not to be an advocate of free trade, I think that would call into question the willingness of foreign investors to supply capital to the U.S. on the same terms that they do today.

It also would diminish the attractiveness of the U.S. because trade protectionist policies do lead to higher inflation that would also undermine investors' willingness to supply goods and services and capital to the United States.

So I think that it is very important that the U.S. be perceived as an advocate of trade liberalization globally.

CHAIRMAN D'AMATO: Commissioner Wessel.

COMMISSIONER WESSEL: I thank the panel, and I appreciate all of you being here today.

One of the other debates going on in Washington is the question of what to do with the surplus and whether we should buy down the national debt. There's some question of whether we're going to accelerate some of the debt buy-backs that might reduce the amount of available federal debt instruments in terms of foreign purchasers.

What implications, if any, do you see in the long term in terms of our carrying out our policies if we do reduce that stock of federal debt in terms of carrying out both fiscal policy, but also the implications long term for economic policy in general?

DR. DUDLEY: People have raised the issue that the dollar as a reserve currency could become less attractive if the Treasury debt were paid off. I suppose it is theoretically possible that it could undermine the currency, but I would imagine that having a country with no outstanding marketable treasury debt would be perceived as a good thing rather than a bad thing in terms of economic strength.

I also think there are lots of other ways you can solve the problem. For example, you could have the Social Security trust fund invest in other assets than Treasury IOUs, which is the current situation. If the Social Security trust fund held agency and corporate debt, then we could maintain a supply of marketable Treasury debt. So that would be another approach.

I do not think that the dollar's reserve currency role will be dramatically undermined if the U.S. does pay off all of our outstanding marketable debt. I also point out you have about \$2.8 trillion of marketable debt. So this idea that we're going to pay

it all off, we've still got a lot of wood to chop in that regard.

MR. HALE: I would add that we have alternatives to Treasury debt for both domestic and foreign investors. We have almost \$4 trillion of agency debt, which is a kind of quasi government debt.

We also have a large market for corporate bonds, as well as commercial paper.

The major challenge in the short term is that as we reduce the stock of Treasury debt by buying it back, we're adding liquidity of a financial system at a time when the Federal Reserve is trying to raise interest rates.

We had the experience in the United Kingdom 12 years ago of Ms. Thatcher's government also running for a couple of years a large surplus. Indeed, she intended to repay all of Britain's public debt going back to the Napoleonic War.

Now, in the process of buying back all of this long dated debt, they basically added liquidity to the financial system and, therefore, made it more difficult in the short term for the bank of England to achieve its monetary policy objective of slowing the economy.

That, in turn, helped to magnify the business cycle and produced a boom-bust in the early 1990s.

We have to also recognize that this debt buy-back, this new fiscal policy does have consequences for monetary policy, but the strategic question of the dollar's reserve currency status, I think, can be addressed through agency securities.

In recent months I've asked Central Bank governors about this question. How will you cope with a shrinking supply of government debt?

They feel in the short term they'll be able to handle the problem because of these alternatives. In ten years' time, we'll have to wait and see.

I would also add that we can't be guaranteed there'll be a surplus there forever. There could be volatility in the U.S. and global business cycle that would turn this surplus into a deficit again in five or six years.

There are plenty of unknowns out there before we finally eliminate the federal debt of the United States.

CHAIRMAN D'AMATO: Commissioner Angell.

COMMISSIONER ANGELL: I appreciate the panel members' agreement that we have a savings

shortfall, and unless that savings shortfall goes away, we're not really going to get the trade deficit down.

Now, I think all of us are aware that we can have Draconian means, that is, David Hale can have -- the economy can go into recession. I guess that would be a solution. Anything that would reduce our capital spending, that would be a solution. In other words, ruin the economy.

Now, what I'd like to hear from you is how do we address the saving imbalance while continuing to have strong capital spending. Can you give me some positive outcomes?

DR. DUDLEY: I think one thing you want to do is have the right mix of monetary and fiscal policy because imagine a situation where you rely on monetary policy to slow the economy down. Let's say fiscal policy is expansive. In that environment you could have a dollar getting very, very strong, and if the dollar got very, very strong, it could overshoot and be followed by a significant decline.

So I think we can increase our chances of achieving a soft landing or sustained economic expansion go up if we have the right mix of monetary policy and fiscal policy.

Right now we're basically asking the Fed. to do, you know, most of the job in restraining the

economy. The fiscal surplus looks like, you know it's leveling off. I think the big risk to us is that we start using that surplus to increase spending or to cut taxes, which would actually reinforce the pressure on the Fed. to take monetary policy, raise interest rates.

That could cause the dollar to overshoot and then ultimately when the economy turned down it collapsed.

DR. DUGGER: My observation would be that we don't have so much of a savings deficiency as we have a consumption excess.

That doesn't seem to be the same thing to me. I don't really doubt that the Congress is going to pass the permanent normal trade relations legislation for China. I think that we will basically be okay on that point.

What I am more concerned about is the trade and services question that the Senator of New York, Charles Schumer, raised earlier. In the end, the capital account is likely to be more of a policy problem than the current account. The trade issue is likely to adjust more slowly than the capital account.

Consequently, as we saw in the mid-1990s, the cry may be more for capital controls than trade controls. It's extremely important for us from a policy standpoint to keep pushing forward on opening trade and services. In order to get John Lipsky's

increase in global savings, we have to have global growth.

Right now Japan is constrained in its restructuring speed by the fact that it only has 12,000 certified public accountants. We have 200 times that in the United States for a population that's only twice as large.

We have to be able to export legal, accounting, and financial services at an unprecedented historic rate, and in this context, we have to make every advance we can in enabling those professional services to be exported.

So I understand the nature of the concern about the vote in Congress on permanent normal trade relations. I'm reasonably confident, however, that if Congress voted for normal trade relations for China immediately after Tiananmen some years ago will probably find its way to do the right thing this time. But I'm not so confident about capital account flows, and I'm not so confident about trade in services, and I think both of those are areas that we need to make as much progress as we possibly can on.

COMMISSIONER ZOELLICK: Mr. Chairman, if I could just add a factual point, there is a difference. In '89 it was sustaining a presidential veto, which takes one third. It's different than one half.

DR. DUGGER: Noted.

CHAIRMAN D'AMATO: Commissioner Rumsfeld.

COMMISSIONER Rumsfeld: Thank you to the panel for your presentations.

I see our time is late here for this panel so I'll be very brief. Dr. Dudley, I thank you for discussing the question as to whether or not the trade deficit is really as large as reported, and you analyzed why you have that question in your mind.

This Commission has the opportunity to make recommendations for improving data, and to the extent you have any specific suggestions now or in writing later, I would appreciate it.

DR. DUDLEY: I certainly would encourage the Commission to use your influence in that area.

COMMISSIONER Rumsfeld: Thank you.

CHAIRMAN D'AMATO: Commissioner Krueger.

COMMISSIONER KRUEGER: I'll add my thanks to everybody else's. I have one question which is really a follow-up to Commissioner Zoellick's.

We talked a bit about the difference between Washington and New York in terms of protection.

I would like those of you who want to respond, but especially Dr. Lipsky, in terms of his comment that the threat to the U.S. economy might be the danger point, what does he think would happen if U.S. protectionist

pressures did get the upper hand, first off, and how would that affect the overall economy?

And then, secondly and in connection with that, is there a scenario where failure to support the WTO in a new round could be the protectionist pressures abroad which might lead to the same unhappy unwinding?

DR. LIPSKY: Absolutely. Thank you. Thank you for that question, and I think it's very important.

Common sense tells us if something isn't broken it doesn't need to be fixed. An important question in your deliberations, therefore, will be whether the size of the trade deficit and the current deficit represent problems that need to be fixed.

The unexpectedly good performance of the U.S. economy during the past few years - particularly the surge in investment and productivity gains - suggests several conclusions. In particular, the combination of deregulated markets and relatively balanced government policies -- both monetary and fiscal -- produce good economic results. It strikes me that that this message is taking hold both here and abroad.

Therefore, it is disturbing to see events like the WTO meetings in Seattle in which the contrary message is publicized, namely that free markets produce

bad results and need to be interfered with for all sorts of reasons.

Rather, constructing protectionist barriers to international trade and capital flows would undermine international investor confidence. The risk would be an end to the late 1990s surge of investment and productivity growth that has contributed so strikingly to U.S. economic progress.

CHAIRMAN D'AMATO: I have one quick question for Mr. Hale.

Mr. Hale, you talk about the rise of the stock market itself as an engine of economic transformation that is a very interesting way to perceive that. You also talk about the possibility of a correction in two to three years based on redirection of capital, say, of emerging markets.

So how do you interpret the decline in the DOW and the increase in the NASDAQ? Is that simply reflective in our own economy of a shift in capital to the high techs or is there more redirection of capital actually occurring now, and is that a reflection of that redirection?

MR. HALE: I think the relative movements in share prices in recent months, and in particular the strength of NASDAQ and weakness of the DOW are an indication of this structural change going on, and it

has in recent months also become self-reinforcing because a very large flow of money in the stock market of the United States today occurs through mutual funds, and mutual fund investors tend to focus most of their new money flows, indeed, 80 or 90 percent on the top ten or 20 funds as rated by the Morningstar Group, and over the last year all of the performance has come from technology oriented funds.

So in recent months we have seen a tremendous flow of money concentrated in technology focused funds and money leaving the so-called value funds, and in recent weeks we've seen some very prominent fund management firms dismiss very prominent people who were associated with the value fund concept. They built their careers on this.

This may be a sign, in fact, that the market is overshooting, but there's no doubt that so far it's been a self-reinforcing process.

I would also add that if we do raise interest rates meaningfully in the year ahead, and there is a scenario, I think, that a year from now the Fed.'s fund rate could be seven percent, this monetary tightening will have a more adverse effect on the so-called old economy companies, traditional durable goods industries and home building, than it will on the so-called new economy sectors.

The new economy sectors are funded by an unprecedented level of venture capital investment. In this country last year, for example, venture capital was worth \$48 billion. Five years ago it was \$6 billion. In the whole of Western Europe last year, it was \$7 billion. In the whole of Japan, it was one or two billion.

This is an unprecedented level of funding, and I've been advised that it might be this year \$60 or \$70 billion. So the new economy sector does not have debt. It has an unparalleled access to equity capital, and therefore, in my opinion, is not as vulnerable to this coming change in monetary policy as the more traditional cyclical parts of the economy, which means this divergence in performance could continue for the time being.

There will be a point out there where valuation gaps become so extreme money flows could reverse, but I cannot tell you today exactly when we're going to reach that point.

CHAIRMAN D'AMATO: Well, I'd like to thank the panel, and this will conclude our first panel.

There's coffee and refreshments behind the dais as a reward for your performance, and we hope you'll also stay around and join us for lunch.

And now I'd like to call to the stand the second panel.

(Whereupon, the foregoing matter went off the record at 10:40 a.m. and went back on the record at 10: 43 a.m.)

CHAIRMAN D'AMATO: If the members of the Commission would join us here at the head table, we'll get this show on the road.

We're pleased to have our second panel with us. It includes the Honorable Gerald Corrigan, who's Managing Director of Goldman Sachs; the Honorable Roger Kubarych, who is the Henry Kaufman Senior Fellow with the Council on Foreign Relations; Jeff Madrick, who is the editor of Challenge magazine; and the Honorable Ed Truman, who is Assistant Secretary of the Treasury for International Affairs.

Thank you very much, gentlemen, for joining us. I think what we'll do is go from left to right. Please try and keep your remarks within ten minutes so that we have a chance for some questions.

The timer in front of you will flash yellow when there are two minutes left, and then please try and sum up.

So thank you very much for joining us, and go ahead, Mr. Corrigan.